

## Appendix P

### Task B Power Point Presentations

- Chinese Venture Capital Business:  
Characteristics, Needs, Development  
Conditions
- Venture Capital In China: Government  
Roles
- Venture Capital Financing

Beijing Seminar on SME Finance  
October 30, 2001

## Chinese V.C business: Characteristics, needs, development conditions

Gao Jian

### Characteristics:

- V.C's development starts with governments' support
- New-tech industrial zones promote V.C.'s development
- Government play a leading role
- Corporations participate in the V.C investment
- Foreign V.C. firms in China are active
- V.C.in China needs a breakthrough

### Needs and scope of Commercial V.C.

- From nationwide perspective, Government-supported equity investment and subsidy are main sources of V.C. But from the beginning of government's supporting, it never locate itself as direct managers, instead, it follows the pattern as "government funding, commercialized operation"
- The trend is the Commercialized V.C will be main source and the government will withdraw from direct participation in the investment, to improving the investment environment.

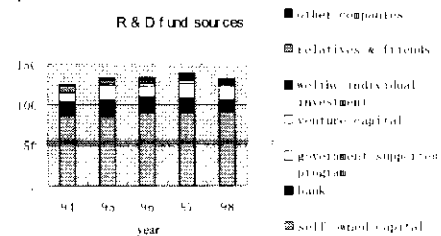
### The indicators to assess the V.C.'s needs

- Ratio of yearly capital influx to GNP: to assess the nation's total needs for V.C.
- Equity gap: to assess the scope of capital needs at the time when the startups feel most difficult to raise funds at their initial stage

### Annual Needs for newly-increased V.C.

- During 1993-1994, in 16 countries including U.S.A., U.K., France etc., the yearly venture capital influx covers 0.053% of the GNP. If we do not count into the U.K., Ireland, the two countries with higher ratio, the average ratio is 0.037%, and the ratio in U.S.A. is 0.05%
- Venture capital influx to China should be within 5.3 billion USD to 3.7 Billion Dollars on the yearly basis (supposed the GNP is one trillion USD) Equal to 40 billion to 30 billion yuan RMB.
- At present, the total amount of Chinese Venture capital is around 30 billion yuan, and the newly-increased capital every year is about 10 billion yuan. According to the international standard, Chinese venture capital is far below the development needs, the annual equity gap is around 20 billion yuan.

### R & D Fund sources in Hi-tech industries in HaiDian Sci-tech Zone



### To assess the equity gap of China's enterprises

- First method: take the innovation fund's subsidy level as an approximate figure. [major through discount loans, the subsidy is given at 50%-100% of the annual loan interest, grant: enterprises need to have equal amount capital to match. The total supporting amount is no more than 1 million yuan and for each supported project, no more than 0.75 million.
- The second method is to take the average amount of each investment invested by venture capital companies (the scope of single investment invested by Chinese V. C. companies is within 1 million-5 million yuan. Almost no investment under 0.5 million yuan, few investment within 0.5-1 million yuan.

### Commercial V.C. companies mainly invest in:

- At present, as the purpose of the government supporting V.C. business is to promote the hi-tech, most of investment is put to hi-tech sectors. The survey results show that the hottest invested sectors are: software, new material, bio-technology
- In future: traditional and high-tech industry, new technology and mature technology sector
- At present: the local government V.C. companies mainly invest in the local enterprises, no cross-geographic investments, but the overseas V.C. companies did the cross-geographic investments since they have strong management, personnel, and capital resources.
- In future, such trend will not change in short term.

### Conditions and terms for development

- Construct venture capital financial system
- Expand the venture capital investment organizations
- Build up new university-enterprises relationship
- Strengthen the training for startup managers

**China**

## Venture Capital in China -- Government Roles

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## I. Overall Picture: Venture Capital In China

- The first foreign fund: 1985
- The first domestic fund: 1986
- Booming: since proposal #1 in 1998
- Two Major Categories of VCs
  - Domestic VCs
    - Government funded, Publicly listed companies, financial institutions, private, MIXED!
  - Foreign VCs
    - MNC, financial institutions, traditional VCs

Data source: VCChina primary research.

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These 130 firms can be divided into 5 categories as shown in the following table:

Category	Number	Industry	Location	Amount of funds (RMB)
VC firms financed by government	60	All	Capitals cities	>200 million
VC firms financed by private individuals	30	Hi-tech	Major cities	≤ 100 million
Foreign VC firms	60	IT	Beijing, Shanghai, Shenzhen	300-500 million*
VC firms financed by public companies	20	Hi-tech	Major cities	10-50 million
VC firms financed by financial institutions	10	All	Capital cities	Uncertain

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## Characteristics of Funds

Fund origin	Management team	Characteristics	Fund scale
Government or state-owned enterprises	Government officials	Strong financial sources, weak management skills.	Large
Partly governmental, partly private firms	Private companies	New form, flexible	Medium
New & high-tech development zones or entrepreneurial parks	Private companies	Invest only in the zone or park	Small

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## Financial Needs: Demand vs. Supply

- Difficult, if not impossible to assess
- Extremely imbalanced for sure

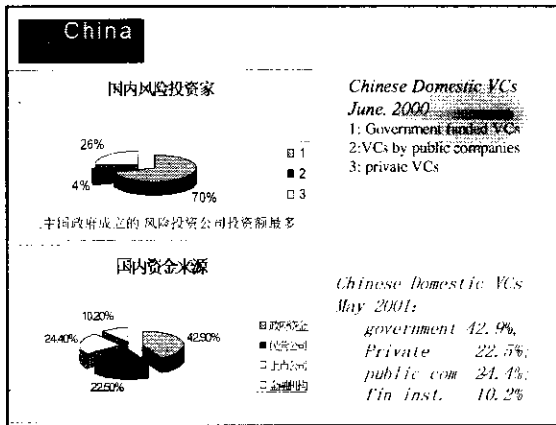
Demand: SOE, Private/Mixed Enterprises

Supply: Major sources of financing: Banking System → SOE; Funds outside Banking system: VC and non VC

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## II. Government Role in Promoting VC in China

- Providing Funds – formation of VC companies
  - Solely Government Owned
  - Government Controlled
  - Government Participated
- Loan Guaranties, insurances
- Regulations and Policies
- Taxes
- Exit routes



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**Characteristics of VCs in China**

- China's Government continued play an important role in China's VC market
- The Sources of VC from government reduced from 70% to 43% in less a year
- Most Foreign VCs slowed down after NASDAQ crashed in spring of 2000, most Chinese domestic VCs seemed not affected
- The Chinese domestic VCs slowed down by the postponed of Chinese domestic second board market

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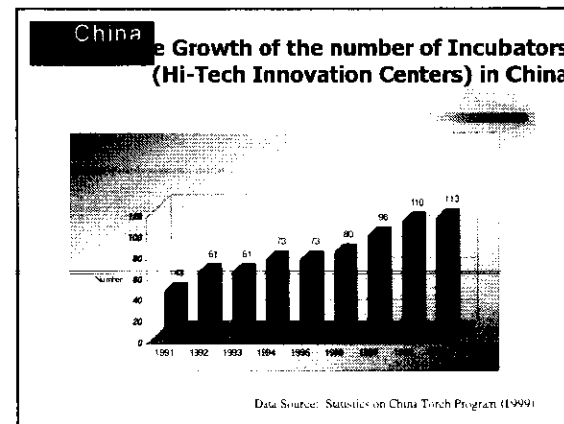
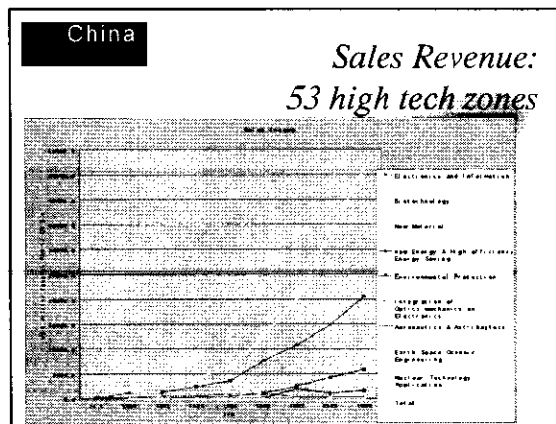
**What has the government done**

- Provides funds -- mostly via local governments
- 53 national high tech zones -- 18,000 + firms, 90% + non SOEs
- taxation and policies: Beijing Zhongguanzun allows VC limited partnerships
- government implicit roles
  - shareholders of corporations
- retreated from decision making roles
- Need to analyze central vs. provincial government roles

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**Government Involvement: Central vs. Provincial-Fund**

- Central:
  - High Tech SME Funds, 2 billion, 7000 projects, local matching, 84% domestic funding
  - 53 National High Tech zones, 794h. GDP, will account for 20% growth
  - Incubators
- Provincial (local)
  - Beijing, 310 m. RMB
  - Shanghai, 600 m. RMB
  - Shenzhen, 500 m. RMB
  - Guangdong, 1 b. RMB
  - JiangSu, 300 m. RMB
  - Shandong, 500 m. RMB
  - Etc.



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*Central vs. Provincial:  
other financing mechanism*

- Central:
  - ???
- Provincial government
  - 28 provinces credit guarantee programs
  - 10 provinces reinsurance programs
  - 80 cities financing guarantee programs
  - Other special programs

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*Central vs. Provincial:  
Regulations*

- Central government
  - Waiting for the final regulations: VCs or Assets management funds?
- Provincial government
  - Beijing, 6 + documents related to VCs in 2 yrs. zhongguancun, GP/FP
  - Shanghai.
  - Shenzhen.
  - Jiangsu - 90/10 partnership. 70/30 profit split

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*Central vs. Provincial: Taxes*

- Central government
  - ???
- Provincial government
  - Beijing, 50% new tax revenue back to high tech.
  - Shanghai, value-added taxes, etc.
  - Shenzhen, 2yrs no tax & 8 years half tax
  - Zhuangzhou: no export taxes

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*Central vs. Provincial  
Government: A Wrap-up*

- Central Government is behind!!!
- Many good initiatives by provincial government need to be summarized and refined to a general level
- Central government role should be different:
  - Macro environment: legal, exiting routes, financial and related regulations, etc.

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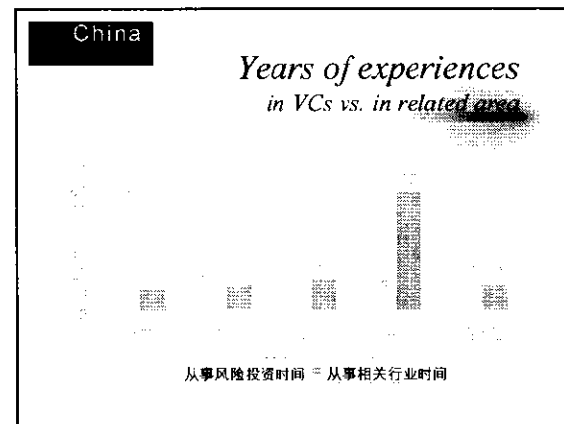
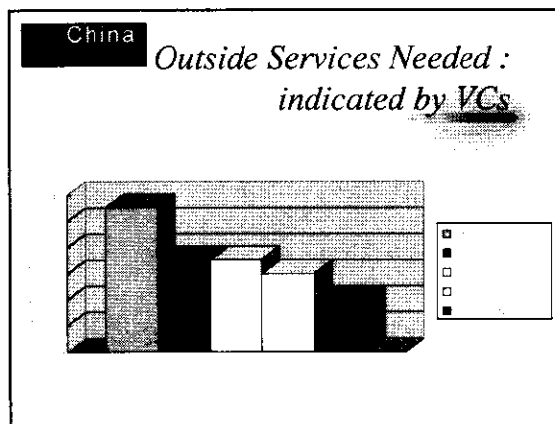
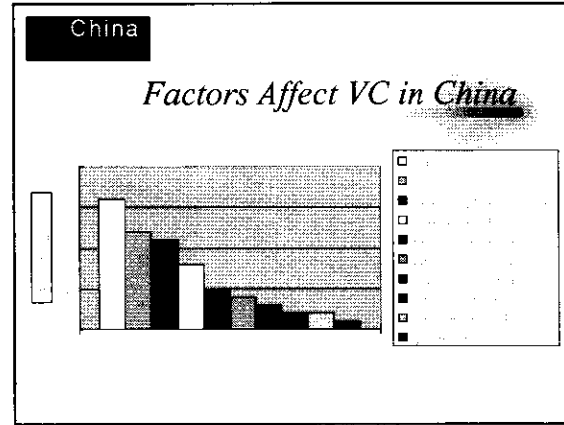
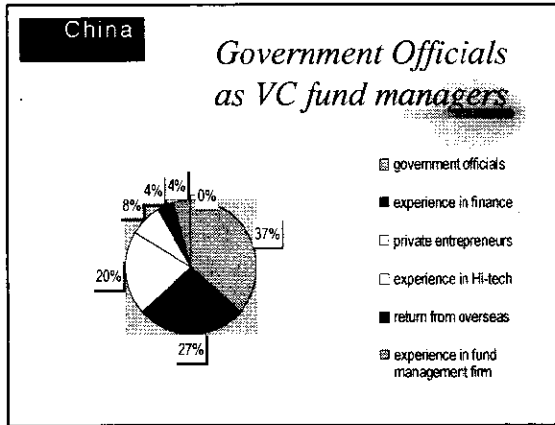
*III. Problems and Suggestions*

- Lack of a legal system: concept of fund -- investment co.; preferred shares; etc.
- Sources of capital: formal VC vs. informal VCs -- angels
- most of money located into later stage
  - lack of management skills
  - lot of unknown factors -- gray market
  - investors pressure to make quick profit
- lack of exiting routes
- lack of foreign assistance

**China**

*One Important among many*

- Bottlenecks, among many
- Real Estate: location, location, location
- VCs: people, people, people
  - Rather invest in grade A team, grade B project
  - Not grade B team with grade A project
- Why?



- China
- ### Training Programs Proposal
- Renmin U. Finance School with VCChina
  - Courses designed
    - Well balanced mixture of modern vc knowledge and the Chinese reality
    - Class lecture vs. practical training
    - Domestic and Foreign education institutes:
      - Harvard, Yale, Boston University
    - Government Support needed

## Venture Capital Financing



Beijing Seminar on SME Finance

October 30, 2001

Robert D. Stillman

## Government and Venture Capital

- Chinese government has encouraged investment in technology-based businesses
- The term Venture Capital, as used here, refers to investments in high-tech companies
- Initiatives of Central government and provincial and local governments have created nearly 200 venture funds - an impressive accomplishment

## Venture Capital Companies

- In addition to domestic companies, a number of foreign venture firms are active.
- From a review of these, we could study:
  - Legal and regulatory impediments to operations
  - Problems of locating and developing investment fund managers
  - Opportunities for non-governmental financing
  - Potential for improving operations

## Legal/Regulatory Impediments

- If China is to have a viable venture capital industry, it must create a body of law to support it.
- Fundamental deficiencies currently exist in laws dealing with:
  - Organization and operation of investment funds
  - Corporate formation and capitalization
  - Exit and securities legislation

## Laws on Investment Funds

- Current law does not allow conventional investment companies
- Without limited partnerships, difficult to provide flexibility and tax pass-through
- No special rules for large or experienced investors
- Government approvals inhibit operations
- Maximum value allowed for intangibles
- Difficult to work with commitments

## Laws on Corporations

- Minimum capitalization inhibits new company formation
- Limitation of a single class of stock precludes creative investment structures
- Restrictions on options and warrants limits ability to align interests of management and investors
- Capital increases subject to approval

### Limitations on Exits

- For many investors this is the most serious issue
- Extended "lockup" period for initial offering
- Repurchase of shares subject to agreement of shareholders and creditors
- Deferral of second board of Shenzhen Exchange

### Investment Fund Management

- Both SME and Venture Funds are only as good as their managers
- Severe shortage of trained investors
- Mature markets rely on "apprenticeship"
- Very few places in China to gain experience
- China must aggressively develop potential managers

### Development of Fund Managers

To accelerate development of venture investment managers, we recommend:

- Development of a training course, using case studies of actual investments:
  - Course must be extensive and last at least a year, with sessions on weekends
  - To be developed and offered either by a university or a private training company such as VC China

### Development of Fund Managers

- Course development will require funding by the Chinese government or a financing institution such as ADB
- Development of a formal intern program, to allow prospective managers to spend several months at the most successful funds
- Active recruitment of overseas Chinese with experience in established venture funds

### Non-governmental Financing

- As with SME Funds, attracting non-governmental investment is a major objective
- With exception of seed and early stage investing, venture capital is attractive to investors without government support, if:
  - Legal barriers are removed
  - Institutional investors are allowed to invest

### Non-governmental Financing

- Investors should be prepared to take the risk and illiquidity of venture investing
- Mixing venture investing or direct investing with open market investing is dangerous and is always avoided in mature markets.

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### Potential Investors

- In China, if laws and regulations permit:
  - Wealthy individuals, domestic and overseas
  - Foreign corporations demonstrating support
  - Listed companies investing excess cash
  - Banks, insurance companies, pension plans
  - International development institutions
  - Municipal and provincial governments.

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### Seed and Early Stage Investment

- In China as in most other markets, venture funds often avoid seed and early stage investing:
  - These are difficult to evaluate
  - They often require only small investments
  - Timing and exits are uncertain
  - Managements require support from investors

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### Seed and Early Stage Investment

- Mature venture markets have “Angel” investors - individuals who invest at an early stage.
- China has very little of this available
- For economic development, seed and early stage investments are very important
- Therefore we recommend the support program for SME investments include investments in technology-based businesses

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### Summary of Recommendations

We recommend:

- Legislation to correct the present legal and regulatory barriers to venture investing
- Development of a training program and intern programs for venture fund managers
- Recruitment of overseas Chinese with venture capital experience

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### Recommendations (Cont'd)

- Changing regulations to allow pension funds and insurance companies to invest 1% of their portfolios in SME and venture capital funds.
- Inclusion of small seed and early stage investments in technology-based companies in SME support program